In the Supreme Court of the United States

OCTOBER TERM, 1943

No._____

LELAND STANFORD JUNIOR UNIVERSITY and ELMER H. SHINE,
Petitioners,

vs.

THE NATIONAL SUPPLY COMPANY, a corporation,
Respondent.

Brief in Support of Petition for Writ of Certiorari

I.

STATEMENT OF JURISDICTION

A concise statement of the grounds on which the jurisdiction of this Court is invoked and as to the jurisdiction of the District Court is set forth in the preceding Petition for Writ of Certiorari* (p. 8), and is incorporated herein by this reference.

*Herein called the "Petition".

II.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 134 Fed.(2d) at pages 689-694 and appears also in the Record at pages 2986-3000. References herein to particular portions of such opinion are to the Record. The opinion of the District Court is not reported, but appears in the Record at pages 211-12.

III.

JUDGMENTS OF DISTRICT COURT AND CIRCUIT COURT OF APPEALS

The judgment of the District Court was entered July 29, 1942, and appears in the Record at pages 313-15. The judgment of the Circuit Court of Appeals was entered April 1, 1943, and appears in the Record at pages 3000-1. The petition for rehearing and for a hearing in bank was denied by the Circuit Court of Appeals on May 22, 1943 (R. 3001).

IV.

CONCISE STATEMENT OF THE CASE

The important facts for consideration of the Petition are set forth in the Petition at pages 2-7 inclusive under the heading "SUMMARY STATEMENT OF THE MATTER INVOLVED". To avoid duplication, that statement is incorporated herein by this reference as our statement of the case. Throughout this Brief we shall refer to the parties

and their predecessors by the same abbreviations as in the Petition, i.e., petitioner Leland Stanford Junior University will be called "Stanford" or "plaintiff", respondent The National Supply Company (a Pennsylvania corporation) will be called "defendant", its predecessor, The National Supply Company of Delaware, will be referred to as the "Delaware corporation" and the other predecessor of defendant, Spang, Chalfant & Co., Inc., will be called "Spang".

V.

SPECIFICATION OF ERRORS

The errors of the Circuit Court of Appeals relied upon, and intended to be urged, will be set forth herein under numbers referring to the corresponding questions presented by the Petition. The Circuit Court of Appeals erred in each of the following respects:

1. (a) In holding that Stanford's representatives were negligent in relying upon a summary of a consolidation plan sent by the directors of the Delaware corporation to Stanford as a stockholder.

(b) If such reliance was negligence, the Court erred in holding that it constituted a good defense to causes of action for deliberate and wilful frauds perpetrated by the directors—fiduciaries—against Stanford—their beneficiary.

2. (a) In holding that the failure by Stanford's representatives to investigate more fully a detailed consolidation plan established contributory negligence as a good defense to Stanford's cause of action for fraud based on the adoption of an unfair plan, when this negligence did

not contribute in any way to the adoption of the plan, but merely resulted in the loss by Stanford of one alternative remedy for such fraud, namely, the statutory appraisal right under Delaware law.

(b) In holding that the Delaware appraisal remedy was an exclusive remedy—a holding necessarily implied in the Court's decision that negligence which resulted in the loss of this remedy constituted a bar to the exercise of any other remedy, and particularly a bar to a suit for damages for the adoption of the unfair plan.

3. In holding that an exchange of securities pursuant to a consolidation plan adopted under Delaware law is not a "sale" within the registration requirements of the Federal Securities Act of 1933.

4. In setting aside important findings of fact without cause, by simply ignoring them, including the findings which contradicted the existence of plaintiff's negligence, the findings as to the wilful and deliberate character of the frauds, which rendered negligence unavailable as a defense, and the findings which negatived laches and estoppel. The ignored findings are more particularly specified in the Petition at pages 5-7 and 12-13.

5. In having plaintiff's petition for a rehearing in bank referred to and passed upon solely by the three Judges who heard the appeal in the first instance and who were less than a majority of the Circuit Court of Appeals.

VI.

SUMMARY OF ARGUMENT

1. The District Court found that both the primary fraud, consisting of the adoption of an unfair plan, and the secondary fraud, consisting of the concealment of the Delaware appraisal right and of the fact that failure to act would result in automatic conversion of plaintiff's stock, were wilful and deliberate frauds on the part of the directors of the Delaware corporation. The Circuit Court of Appeals reverses the District Court primarily by holding that plaintiff's representatives were guilty of contributory negligence in relying upon the letter sent to them by the directors instead of reading the entire plan and agreement. This holding of negligence is itself erroneous, because the District Court found that the letter appeared to be a summary of the plan and agreement and was intended by the directors so to appear and therefore Stanford, as a stockholder, was entitled to rely upon the letter. However, assuming for argument that the reliance on the letter was negligence, the holding that this is a defense to liability for an intentional wrong done by fiduciaries to their beneficiary is contrary to the local law of California, as established by California decisions, and contrary to the local law of all other states as established not only by state court decisions but by those of the United States Supreme Court and other Circuit Courts of Appeals.

2. If Stanford's reliance on the letter was negligence, it may have contributed to the secondary fraud, namely, the concealment of the appraisal right and of automatic conversion, but it did not contribute in any way to the primary fraud, because it had nothing to do with the

adoption of the unfair plan. By holding that this negligence, resulting in loss of the appraisal right, also barred one of plaintiff's alternative remedies, namely, an action at law for damages for fraud, the Circuit Court of Appeals necessarily decides that the Delaware appraisal remedy is the sole and exclusive remedy. In this it conflicts directly with an applicable Delaware decision, with a decision of the Circuit Court of Appeals for the First Circuit in which certiorari was denied by the Supreme Court, with numerous other state court decisions involving similar statutes, and even with a dictum rendered in a prior case by another group of Judges of the Ninth Circuit.

3. The offer of an exchange of stocks pursuant to the consolidation plan, as made to plaintiff in this case, required registration under the Federal Securities Act of 1933, because the term "sale" as used in that Act ordinarily includes an exchange, and there is no express exemption of an exchange pursuant to a plan adopted by stockholders and directors acting in their corporate capacities. The intention of Congress to have such an exchange included within the registration requirements is demonstrated by certain express exemptions in the Act, which would have been unnecessary if such an exchange were not included, and is also proven by the 1933 House Committee Report, which expressly stated that mergers and consolidations were not exempted by the statute. The facts in this case demonstrate that the evils against which the Act was aimed require registration just as much in the case of a consolidation as in any other promotion. Furthermore, since each stockholder here had his choice be-

tween three alternatives, individual action was required and thus any exchange which was offered would not result solely from the action of directors and stockholders in their corporate capacities.

4. Rule 52(a) of the Federal Rules of Civil Procedure requires that findings of fact be not set aside by an appellate court unless clearly erroneous. It was a violation of this rule for the Circuit Court of Appeals to set aside findings of the District Court by merely ignoring them and without any examination of the Record with respect to such findings. The findings so erroneously ignored include some of the most important findings which, if given weight, would necessarily have altered the decision on appeal. They include the findings of deliberate intent to defraud which prevented negligence from constituting a defense, the finding as to the "summary" character of the letter, which demonstrated the absence of negligence, and the findings which negatived the existence of estoppel or laches.

5. The action of the Circuit Court of Appeals in referring plaintiff's petition for a rehearing by the entire Court *in bank* solely to the three Judges—less than a majority of the Court—who heard the appeal in the first instance appears erroneous, but since this action does not affect the merits of plaintiff's case, no argument on this point is presented beyond reference to the questions on this subject raised in the preceding Petition and the suggestion that the problems involved should be passed upon by the Supreme Court.

VII.

ARGUMENT

1. THE CIRCUIT COURT OF APPEALS ERRED IN HOLDING THAT CONTRIBUTORY NEGLIGENCE, IF ESTABLISHED, IS A GOOD DEFENSE TO WILFUL AND DELIBERATE FRAUDS BY DIRECTORS AGAINST A STOCKHOLDER.

The Reversing Opinion* is so exclusively devoted to exposing oversight on the part of Stanford's representatives that it never reaches the point of analyzing the wrong-doing of the directors of the Delaware corporation, defendant's predecessor, for whose acts defendant is responsible to plaintiff Stanford. The Reversing Opinion fails to state that the frauds of such directors were intentional and deliberate, nor does it discuss whether that fact affects the availability of negligence as a defense. It is as if the Circuit Court of Appeals had considered this case analogous to one where a plaintiff suffers a personal injury in an accident caused by the unintentional negligence of defendant's agent. Actually this case is like one where defendant's agent wilfully aims a gun at plaintiff and shoots and wounds him. In such a case, of course, no amount of negligence of the plaintiff is a defense.

Magar v. Hammond (1906) 183 New York 387; 76 N.E. 474; 3 L.R.A. (N.S.) 1038.

The Findings of Deliberate Intent to Defraud.

(a) The Primary Fraud—Adoption of an Unfair Plan.

The findings of the trial court as to the character of the frauds are perfectly clear and they are not questioned

*We refer to the opinion of the Circuit Court of Appeals (R. 2986-3000) as the "Reversing Opinion".

by the Reversing Opinion. The primary fraud against plaintiff was the adoption of an unfair consolidation plan for the Delaware corporation and Spang, its subsidiary, out of which defendant emerged as the consolidated corporation and by which plaintiff was deprived of a large part of the value of its preferred stock and the unpaid arrears of dividends on such stock. As to this fraud the findings are not only that the plan was grossly unfair in result, depriving the preferred stock of more than $6,000,000 in value—between one-third and one-quarter of its total value—and transferring all this value to the common stock (R. 249-51 and R. 274); but, what is more important, the findings are that this result was deliberately designed by the directors for the wrongful purpose of benefiting the common stock, of which such directors were predominantly holders, and the largest holders. This is demonstrated by the following description of detailed findings.

On this subject the District Court found that the controlling directors were primarily large common stockholders (R. 235-7);* that the director who took the lead in financial plans (R. 239) resolved upon the purpose of extinguishing the arrears of preferred dividends

> "without paying the same in cash, by means of some form of reorganization, recapitalization or other means, and that by the same means and at the same time the dividend requirements, redemption and liquidation preferences and other preferences attached to the said 7% preferred stock should be reduced, to

*They included the two largest holders of common (R. 695).

> the end that the value of the common stock * * * would be enhanced at the expense of the holders of said 7% preferred stock, and so that the holders of said common stock would be placed in a position to receive dividends thereon" (R. 238).

It is further found that the other directors learned of this purpose and "accorded therein" (R. 238) and thereafter followed the lead of this director who first adopted such purpose (R. 239); also that consolidation was only adopted on the advice of the attorney for the Delaware corporation (who was also a director)

> "that consolidation was the only way in which the said purpose of eliminating said arrears of dividends on said preferred stock without payment in cash and of changing the preferences and rights attached to said preferred stock could be accomplished" (R. 246-7).

Numerous findings show that this intent of taking values from the preferred for the benefit of the common carried through all the planning which resulted in the final consolidation plan (R. 239-49); but these constitute mere detailed support for the further finding that in and by the formulation of the final plan,

> "the said purpose of the board of directors of eliminating the arrears of dividends upon the 7% preferred stock * * * without payment, and of reducing the preferences and other rights attached to said preferred stock, and thereby enhancing the value of the common stock * * * at the expense of the holders of said preferred stock, was fully accomplished" (R. 249-50),

subject only to approval by stockholders' vote and avoidance of too many cash demands (R. 250). In the same paragraph the District Court finds that

> "At the time the board of directors of The National Supply Company of Delaware adopted said plan on August 10, 1937, said board knew that said plan had been fixed upon for said purpose, and knew that it would have said effect" (R. 250-51).

Further detailed findings show that the directors, in the letter to stockholders which they sent out over the signature of the President, made numerous false and misleading statements in order to obtain the stockholders' approving vote and to minimize dissents (R. 251-66); but these merely furnish further proof of the wilfulness of the primary fraud and demonstrate that the vote of the stockholders was meaningless because obtained by fraud. With respect to plaintiff Stanford, which did not vote for the plan, but refused its proxy (R. 280), the more important findings are those as to the ultimate accomplishment of the directors' intent to injure its preferred stock. We quote them as follows from paragraph 41 of the findings:

> "41. The said Agreement and Joint Plan of Consolidation was decided upon, formulated and effectuated by the board of directors of The National Supply Company of Delaware as a means of cancelling the arrears of dividends upon the 7% preferred stock of said corporation without payment and of reducing the value, rights and preferences of said preferred stock, all without any or substantial equivalent therefor. Said board of directors considered that the common stockholders of said corporation would be bene-

fited by said Agreement and Joint Plan of Consolidation, by and through said elimination of arrears and reduction of the value, rights and preferences of said preferred stock. Said board of directors regarded and treated the preferred stockholders as parties having adverse interests which it was desirable to reduce and cut down. Except as last stated, the said board of directors did not consider said consolidation to be advantageous, beneficial or desirable to or for The National Supply Company of Delaware or its shareholders." (R. 275)

Most important of all is the finding that the directors' purpose was to benefit themselves:

"44. In and by the effectuation through said consolidation of their said object and purpose of enhancing the value of the common stock of The National Supply Company of Delaware at the cost and expense of the holders of the preferred stock of said corporation, the majority of the directors expected and intended that their own personal interests would be substantially and materially improved, and all the board of directors knew and expected and intended that said improvement would be accomplished at the expense of and to the loss of the holders of the said preferred stock." (R. 278)

The adoption of an unfair plan of consolidation or other unfair corporate plan by controlling directors is, of course, fraud. See the following authorities among many so holding:

Allied Chemical & Dye Corporation v. Steel & Tube Co. (1923) 14 Del.Ch. 1, 120 Atl. 486;

Federal United Corp. v. Havender (Del., 1940) 11 Atl.(2d) 331, 339-343 (dictum only);

Jones v. Missouri-Edison Electric Co. (C.C.A., 8, 1906, 1912, 1913) 144 Fed. 765; 199 Fed. 64; 203 Fed. 945; (Cert. den. 229 U.S. 615);

Outwater v. Public Service Corp. of N. J. (1928) 103 N.J.Eq. 461, 143 Atl. 729 (Aff'd 104 N.J. Eq. 490; 146 Atl. 916);

Goodisson v. North American Securities Co. (1931) 40 Ohio App. 85, 178 N.E. 29;

Boyd v. N. Y. & H. R. Co. (D.C., S.D., N.Y., 1915) 220 Fed. 174; and

Tower Hill-Connelsville Coke Co. v. Piedmont Coal Co. (C.C.A., 4, 1933) 64 Fed.(2d) 817; (Cert. den. 290 U.S. 675).

Such a plan is "constructive" fraud regardless of intent, but when directors adopt the plan to feather their own nests, as here found, there can be no doubt that it is actual fraud—wilful and deliberate fraud.

(b) The Secondary Fraud—Concealment of the Appraisal Remedy and of Automatic Conversion.

The secondary fraud aimed at Stanford was for the purpose of aiding the primary fraud and was equally intentional. It consisted of the concealment of the Delaware statutory appraisal right and the further concealment of the fact that if stockholders did nothing, they would lose this right and their old stock would be extinguished by automatic conversion into securities of the new company.

The District Court found that the right under the Delaware statute to obtain fair value pursuant to an

appraisal, including the necessity of timely objection and demand in order to avail of such right, was concealed by omission from the letter sent to stockholders, although other alternative rights were carefully explained (R. 261-2); also that the fact that the old preferred stock and accrued dividends would be extinguished by automatic conversion into securities of the new company was not only omitted, but was affirmatively concealed by the way in which the letter to stockholders was drawn (R. 260).

But more important than these findings of omissions from the letter are the findings as to the deliberate purpose of the directors in that connection. The findings as to the omissions above mentioned are all contained in subparagraphs of paragraph 32 of the findings and are preceded by the finding that

> "the Prospectus was by the said board of directors carefully drawn and prepared and the said omission of said facts† therefrom by the said board of directors was intentional and deliberate." (R. 259)

Near the end of paragraph 32 it is further found as follows:

> "and The National Supply Company of Delaware and its president and board of directors and each of them knew said facts and intentionally omitted the same from said Prospectus * * * for the purpose and with the intent of concealing said cash alternative from stockholders, and of leading stockholders into the belief that said cash alternative was not available, and into the belief that stockholders were not to be deprived of their former rights without their

†i.e. the appraisal right and automatic conversion.

> consent, and for the purpose and with the intent of avoiding as far as possible the payment of cash to stockholders, in order to accomplish said consolidation without affording stockholders notice of or a fair opportunity to exercise said right to cash payment, and of forcing said exchange upon them without their knowledge or consent." (R. 263-4)

The reason for such intent of the directors and the deliberate character of the fraud are further explained in paragraph 48 of the findings, which reads in part as follows:

> "The board of directors of The National Supply Company of Delaware desired to have as few objections and dissents as possible, in order thereby to minimize the amount of money that the defendant would have to expend in paying to dissenting stockholders the fair value of their stock, and because of said desire and in order to minimize said amount said board of directors deliberately concealed said right to payment of value in money, as more particularly set forth in paragraph 32 of these findings." (R. 281)

A misleading omission is, of course, just as much a fraud as an affirmative misstatement.

> *Stewart v. Wyoming Ranche Co.* (1888) 128 U.S. 383;
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> *Equitable Life Insurance Co. v. Halsey, Stuart & Co.* (1941) 312 U.S. 410, 426.

In this case, therefore, there can be no doubt that both the primary and the secondary frauds were established as wilful and deliberate frauds.

The Reversing Opinion Sustains the Defense of Negligence.

The basic holding of the Reversing Opinion is that recovery by plaintiff is precluded by the negligence of plaintiff's financial analyst and investment committee of trustees. After discussing the only two cases† cited in the Reversing Opinion, neither of which involved any claim of fraud or even unfairness in result except by way of dictum, the Reversing Opinion says:

> "In this frame of reference we are obliged to consider Stanford's diligence or the lack of it. Certainly there was ample time to investigate and to pursue such inquiries as might reasonably have suggested themselves to a stockholder as persuaded of the injustice of the proposal as this one was. * * * How did the committee and its analyst employ this time and what use did they make of the literature?" (R. 2995)

The Reversing Opinion then proceeds to hold that although the letter to stockholders did not explain the automatic conversion of the stock,

> "The shareholder who had read the letter with a degree of intelligent care could not but be put on inquiry as to the fate of his existing holdings in the event of a merger. * * * Had the agreement itself been examined all rational doubt on the subject would have been set at rest. On this phase of the matter we conclude that Stanford was not lulled into a sense of security. It was merely mistaken." (R. 2996-7)

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†*Federal United Corp. v. Havender* (Del., 1940) 11 Atl.(2d) 331, and *Windhurst v. Central Leather Co.* (1927) 101 N. J. Eq. 543, 138 Atl. 772.

This is a conclusion of negligent mistake.

The Reversing Opinion treats similarly the result of the letter's failure to disclose the Delaware appraisal remedy. At R. 2997 the Reversing Opinion explains that although the letter was silent on the subject, a careful reading of the rest of the literature, particularly the "Agreement and Joint Plan of Consolidation" would have disclosed some references to the existence of this remedy—not a full explanation of its character but references sufficient to excite further inquiry as to what the remedy was and how it should be exercised. The Reversing Opinion says:

> "Had the analyst or some member of the committee been at pains to read the literature the existence of the legal right to dissent and demand payment could not well have escaped their attention." (R. 2997)

Following this passage the Reversing Opinion holds that Stanford was under a greater duty of care than the ordinary stockholder, because it realized the unfairness of the plan. It is said:

> "A stockholder who is induced by the literature sent him to believe that a proposed merger is fair, though in fact it is not, is not led to inquire as to his legal rights in the premises. * * * But not so a stockholder entertaining the views of Stanford. As a reasonable person he would want to know what provision, if any, is made by the law of the corporate domicile for taking care of the dissenter. We gather that the committee was content to forego so vital an inquiry because its members mistakenly believed that the University was entitled to keep its stock,

> consolidation or no consolidation. Thus an assumption indulged in without a reason and without inquiry induced the complacency which characterized the conduct of this stockholder throughout." (R. 2997-8)

In other words, the Circuit Court of Appeals concludes that because Stanford realized the unfairness of the plan in result, it should have been especially suspicious of the letter to stockholders and was therefore negligent in not also examining in detail the document which the letter appeared to summarize.*

All this is a decision that plaintiff failed to exercise a high degree of care. The discovery by the Circuit of Appeals of any negligence at all is factually erroneous, in view of the fact that the District Court heard in person the testimony of plaintiff's financial analyst and investment committee members, as well as the testimony of the attorney-director of the Delaware corporation who actually prepared the letter to stockholders and the other documents, and that thereafter the District Court found expressly that the letter

> "appeared to be and was, and was by the said board of directors intended to appear as and to be, and the plaintiffs believed the same to be, a statement

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*While Stanford did realize from its careful examination of the letter that the plan was unfair *in result*, it could not then know that the directors *deliberately intended* this unfairness to feather their own nests. It did not find out about this intent until the depositions were taken after the suit was pending in the court below. (Finding paragraph 53, R. 283-5.) Had Stanford known of the dishonest intent, as well as the unfair result, it might have suspected wilful fraud in the letter and might have extended its investigation.

> of the purport and effect of the Agreement and Joint Plan of Consolidation and the reasons therefor, and plaintiffs and each of them relied thereon as being a statement of the purport and effect thereof and of the reasons therefor." (R. 259)

Although the letter thus appeared to be a summary of the legal agreement and was intended by the directors so to appear,* the Circuit Court of Appeals reverses the District Court decision that plaintiff was entitled to rely on the summary as such and the appellate court holds that it was negligence for plaintiff to treat the letter as a summary† and not to read the legal document which it summarized or perhaps employ an attorney to analyze that document and advise about the Delaware law.

Such a holding of negligence will be surprising to anyone who believes that a letter authorized by the directors and signed in the name of the president of a corporation, summarizing an important corporate plan, must either state all the important facts about the plan or else explain expressly that it omits *important* matters. Conceding, however, for argument's sake, that such holding could be justified as a factual holding under all the circumstances of this case, it would be at most a decision that plaintiff did not exercise due care in failing to make a more ex-

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*This particular part of the finding is based upon allegations in plaintiff's complaint (R. 35) which were admitted in the answer (R. 162).

†The Record shows without conflict that plaintiff's financial analyst studied the letter thoroughly (R. 481-2) and relied on it as a summary of the legal agreement (R. 489); also that one member of the investment committee looked the letter over and the other member present at the meeting relied on the financial analyst's report based upon the letter (R. 420, 450, 491-3).

tensive inquiry. That is a holding of contributory negligence.

The Conclusion That Contributory Negligence Is a Defense to Wilful Fraud by Fiduciaries Is Contrary to the Local Law of California and All Other States and Conflicts with Decisions of the Supreme Court and Other Circuit Courts of Appeals.

It is when the Reversing Opinion finally concludes, without the least discussion, that the negligence so assumed by the appellate court bars plaintiff's recovery for an intentional wrong done by fiduciaries to their beneficiary, that it becomes clearly erroneous as a matter of law. In holding that negligence is a defense to a wilful fraud, even in the absence of any consideration of the fiduciary relationship, the Reversing Opinion runs directly counter to the law of California, where the frauds were consummated against plaintiff Stanford and from whose courts this case was removed. As the California Supreme Court said in a case where plaintiff likewise failed to investigate further:

> "* * * Negligence on the part of the plaintiff in failing to discover the falsity of a statement is no defense when the misrepresentation was intentional rather than negligent. (See cases cited in 12 Cal. Jur. 758, 759; Prosser, Torts, 748.) As a general rule negligence of the plaintiff is no defense to an intentional tort. (See Prosser, Torts, 402.) The fact that an investigation would have revealed the falsity of the misrepresentation will not alone bar his recovery. (Rest. Torts, sec. 540; see cases cited in 12 Cal. Jur. 758, 759) * * * Nor is a plaintiff held to the standard of precaution or of minimum knowledge of a hypothetical, reasonable man. * * * 'No rogue

> should enjoy his ill-gotten plunder for the simple reason that his victim is by chance a fool.' (Chamberlin v. Fuller, 59 Vt. 247 [9 Atl. 832, 835].) * * * The fact that an examination of the record would have revealed to plaintiffs the falsity of the representation or that they may have been negligent in failing to make further investigations does not bar their right to relief."
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> *Seeger v. Odell* (1941) 18 Cal.(2d) 409, 414-15; 115 Pac.(2d) 977, 980-81.

To the same effect see

> *Security-First National Bank v. Earp* (1942) 19 Cal.(2d) 774; 122 Pac.(2d) 900;

and other California authorities cited in that case. The law of all other English and American jurisdictions is the same on this question. See, for example,

> *Equitable Life Insurance Co. v. Halsey etc. Co.* (1941) 312 U.S. 410;*
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> *W. P. Walker & Co. v. Walbridge* (C.C.A., 5, 1905) 136 Fed. 19 (Cert. den. 199 U.S. 605);
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> *Martin v. Burford* (C.C.A., 9, 1910) 181 Fed. 922, 926;
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> *Directors etc. of Central Railroad Co. of Venezuela v. Kisch* (House of Lords, 1867) L.R. 2 H.L. (E.&I. App.) 99, 120-1;
>
> *Albany Savings Institution v. Burdick* (1881) 87 N.Y. 40, 49;

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*This case also involved a fraudulent omission in connection with securities and the Supreme Court held that since the fraud was intentional the plaintiff did not have to inquire further, although it could have found out if it had. The question whether negligence was a defense was argued expressly in the briefs. The case involved Iowa law.

Griffith v. Parks (1911) 165 Ill.App. 337; and
Schweyer & Co. v. Mellon (1917) 196 Mich. 590; 162 N.W. 1006.

Many similar cases are cited in 26 *C. J.* 1147-9, 45 *C. J.* 981-2, 23 *Am. Jur.* 963 and 38 *Am. Jur.* 854.

There are, of course, situations in which a plaintiff, dealing at arm's length with the defendant and having his own full means of information, is precluded from recovery because he has been negligent in *relying* on defendant's false statement. But where the defendant is a fiduciary or where, even in the absence of confidential relations, the defendant obviously has superior knowledge of the facts, it is both the law of California and of other states generally that plaintiff is not barred from recovery for intentional fraud by negligence in relying on the defendant's statement and thus failing to investigate further.

Rutherford v. Rideout Bank (1938) 11 Cal.(2d) 479, 485-6; 80 Pac.(2d) 978, 981-2;
Barron Estate Co. v. Woodruff Co. (1912) 163 Cal. 561, 574-7; 126 Pac. 351, 356-8;
Falter v. United States (C.C.A., 2, 1928) 23 Fed. (2d) 420, 424 (Cert. den. 277 U.S. 590);
Blakeslee v. Wallace (C.C.A., 6, 1930) 45 Fed. (2d) 347, 352;
Cases cited in 26 *C. J.* 1158-9 and 23 *Am. Jur.* 966-7.

Here, of course, the wilful fraud was committed by the directors of the Delaware corporation, who were both fiduciaries for the stockholders and also persons possessed of inside knowledge and legal advice as to all facts and

results of any corporate plan. Thus there can be no doubt that the Reversing Opinion errs in upholding the defense of contributory negligence, and in this respect not only conflicts with state law but also with the decision of the Supreme Court in *Equitable Life Insurance Co. v. Halsey etc. Co.,* above, and with at least the Circuit Courts of Appeals of the Second, Fifth and Sixth Circuits in the cases decided by those courts which are cited in the last two lists above.

2. **THE CIRCUIT COURT OF APPEALS ERRED IN HOLDING THAT PLAINTIFF'S NEGLIGENCE, WHICH RESULTED ONLY IN LOSS OF ITS DELAWARE APPRAISAL REMEDY, ALSO BARS PLAINTIFF'S ACTION AT LAW FOR DAMAGES.**

For argument's sake, we assume in this point, contrary to the express findings of the trial court, that plaintiff's representatives were negligent, as the appellate court holds. This assumed negligence, however, consisted of a failure to investigate and find out about the Delaware statutory right to obtain fair value through an appraisal.* It did not in any way contribute to the primary fraud, namely, the adoption by the directors of an intentionally unfair consolidation plan, which act is denominated by the law as a fraud.

Actually that act of the directors was an abuse of power by fiduciaries acting against the interests of their beneficiaries (the stockholders). In its effect upon this plaintiff it did not depend upon deception, for Stanford was not deceived, since it realized the plan was unfair in re-

*Section 61 of the General Corporation Law of Delaware quoted in the Appendix to this Brief, pages vi-viii.

sult, as the Reversing Opinion itself recognizes (R. 2989). The fraud did depend upon deception of other stockholders in order to get their vote, but the gist of the wrong done to plaintiff was the forceful deprivation of value of the preferred stock and this was like an intentionally wrongful conversion of stock or other wilful destruction of property.

The Circuit Court of Appeals seems to overlook the existence of the primary fraud. Perhaps this is because the short opinion of the District Court (R. 211-212) was devoted principally to the secondary fraud—the deceptive letter—and merely mentioned "circumstances in evidence which amounted to a breach of trust on the part of the directors and officers * * *" and that the "plan of consolidation * * * would operate to drastically alter * * * property rights" of stockholders in the old corporation (R. 211). However, regardless of the correct interpretation of the trial court's opinion, the "Findings of Fact and Conclusions of Law" subsequently made by that court (R. 225-287) described fully both the primary and secondary frauds; and, of course, it is the formal findings of fact and conclusions of law which constitute "the juridical act formalizing the court's decision."

U. S. v. Fifty-Nine Tubes, etc. (D.C., S.D., N.Y., 1940) 32 F.S. 958, 963;

American Insurance Co. v. Scheufler (C.C.A., 8, 1942) 129 Fed.(2d) 143, 146.

Stanford's representatives had nothing to do with this primary wrong—the adoption of the unfair plan—and their negligence did not contribute to it. The wrong was

entirely the work of the directors of the Delaware corporation; indeed, Stanford refused to give a proxy to vote its stock for the plan (Finding, R. 280).

What the negligence actually did was to cause Stanford to lose the Delaware statutory appraisal right, and nothing more. Thus the negligence contributed only to the secondary fraud, namely, concealment of that appraisal right.

But as for the primary fraud—the unfair plan—Stanford had other remedies equally available, including an injunction suit, an equitable or declaratory proceeding to declare the consolidation void, and an action at law for damages.* It chose this last remedy, the action at law. And it could have done so, had it known all about the alternative appraisal remedy; indeed, it could have chosen the action at law for any reason that suited it, such as, for example, its objection to having appraisers who would be subject to disqualification or appointment by a court in Delaware,† or its preference for courts over arbitration.

In holding that the failure of Stanford to find out about the Delaware statutory remedy precludes any recovery in this action, the Reversing Opinion, in effect, decides that the Delaware remedy is the sole and exclusive remedy; for surely if there were several alternative remedies equally available to a stockholder, the loss of

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*An action for money damages for fraud is an action at law. *Philpott v. Superior Court* (1934) 1 Cal.(2d) 512, 36 Pac.(2d) 635; *Shippen v. Bowen* (1887) 122 U.S. 575, 582-3; *James-Dickinson Co. v. Harry* (1927) 273 U.S. 119, 121, 126.

†See *Scott v. Arden Farms Co.* (Del. Ch., 1942) 28 Atl.(2d) 81, for some of the difficulties arising in a Delaware statutory appraisal.

one of them through negligence would not lose the others. The whole Reversing Opinion assumes that the loss of the appraisal remedy lost everything for plaintiff and thus implicitly decides that the Delaware statutory remedy was exclusive. In this it conflicts directly with an applicable Delaware decision, with a decision of the Circuit Court of Appeals for the First Circuit in which certiorari was denied by the Supreme Court, with numerous other state court decisions involving similar statutes and even with a dictum rendered in a prior case by another group of Judges of the Ninth Circuit.

The Delaware decision, above mentioned, is

> *Cole v. National Cash Credit Ass'n.* (1931) 18 Del.Ch. 47, 156 Atl. 183,

which established the law of Delaware with respect to the very merger and consolidation statutes involved in this case. The case arose from a merger, but the same statutory appraisal remedy is provided for a merger as in the case of a consolidation. On the question as to the exclusiveness of this remedy, the Delaware Court of Chancery said in the opinion, 156 Atlantic at 187:

> "* * * Furthermore, if consent to the merger be induced by fraud practiced upon a consenting company, a stockholder is under no duty to elect whether he will abide by a merger so induced or take his money. In such a case equity holds that no just alternatives are presented to him for a choice. See Bailey v. Citizens' Gas Light Co., 27 N.J.Eq. 196; Wilson v. Trenton Pass. Ry. Co., 56 N.J.Eq. 783, 40 A. 597. Where also the merger proposes illegally to wipe out a right to accumulated dividends

> on preferred stock, a court of equity will enjoin it on the application of a preferred stockholder. In such a case the stockholder's election is invited between two alternatives one of which is highly unfair. See Colgate v. U. S. Leather Co., 73 N.J.Eq. 72, 67 A. 657, reversed on other grounds, 75 N.J.Eq. 229, 72 A. 126, 19 Ann. Cas. 1262. From these and other cases which may be cited it thus appears that the election which is given to the stockholder is one that he is not, under any and all circumstances, required to exercise. The exercise of the statutory right of merger is always subject to nullification for fraud. The cases so hold."

The First Circuit case which conflicts squarely with the present decision of the Ninth Circuit is

> *May v. Midwest Refining Co.* (C.C.A., 1, 1941) 121 Fed.(2d) 431, 438 (Cert. den. 314 U.S. 668).

That case involved a sale of corporate assets rather than a merger or consolidation and the law of Maine rather than that of Delaware, but the Maine statute afforded a similar appraisal remedy without any express provision that it was exclusive and the Circuit Court of Appeals held that, in the absence of such an express provision, it was not. See particularly 121 Fed.(2d) at 438.

To the same effect are many state court decisions involving appraisal remedies in merger and consolidation statutes and in other statutes providing for important corporate acts affecting stockholders' rights. We cite the following as examples of the many decisions holding that the appraisal remedy is not exclusive:

Outwater v. Public Service Corp. of N. J. (1928) 103 N.J.Eq. 461, 143 Atl. 729;

Goodisson v. North American Securities Co. (1931) 40 Ohio App. 85, 178 N.E. 29;

Barnett v. Philadelphia Market Co. (Pa. 1907) 218 Pa. 649, 67 Atl. 912;

Langan v. Francklyn (1892) 20 N.Y.S. 404, 413-414.

Indeed, the Circuit Court of Appeals for the Ninth Circuit has itself recognized this rule, as distinguished from the principle applicable to the California statute, Civil Code Section 369(17), which expressly provides that the appraisal remedy in the case of a California corporation is exclusive. See

Beechwood Securities Corp., Inc. v. Associated Oil Co. (C.C.A., 9, 1939) 104 Fed.(2d) 537.

There the opinion by Judge Denman, concurred in by Judges Garrecht and Mathews, upheld the exclusive provision of the California statute, but carefully pointed out that statutes of other states, which did not contain this exclusive provision, did not limit the stockholder to the appraisal remedy. Thus at 104 Fed.(2d) 540, the opinion said:

> "Other states permit corporate consolidation, with the duty of the majority to offer stock in the consolidated or merged corporation, and provide for the appraisal of the shares, if the offer is not accepted, without limiting the refusing shareholder's right to a payment of the fair market value of his shares. In the absence of such a limitation of his right the courts of these states, in dicta or holdings, construe

> the statutes as giving the shareholder the right to litigate the question of fraud in the proffered exchange of his old shares for that in the consolidated corporation and equitable relief where the exercise of that right is fraudulently prevented.[2]"

The footnote "2" referred to at the end of this passage and appearing at 104 Fed. (2d) 540-541 includes the Delaware case of *Cole v. National Cash Credit Association,* above discussed, and numerous other state court cases which we have not cited, but which might well be added to the above list.

It was particularly because of the conflict between the above quoted passage from the opinion in the *Beechwood* case and the contrary decision in the instant case rendered by Judge Healy and concurred in by Judges Garrecht and Haney that we sought a rehearing by the Circuit Court of Appeals sitting ***in bank***.

3. **THE CIRCUIT COURT OF APPEALS ERRED IN HOLDING THAT THE EXCHANGE OF STOCK FOR STOCK IN A CONSOLIDATION WAS NOT A "SALE" WITHIN THE MEANING OF THE FEDERAL SECURITIES ACT OF 1933.**

The new securities issued by defendant under the consolidation plan were not registered with the Securities and Exchange Commission (R. 279), although the mails were used to offer them (R. 278-9). We contended that this constituted a violation of the Federal Securities Act of 1933 and particularly of Sections 5(a) and 12(1) of the Act.* The Circuit Court of Appeals, however, held that the exchange of securities was not a "sale" (and therefore

*Quoted in Appendix to this Brief, pages viii-ix.

the offer to exchange them was not an offering of "sale") within the definition of Section 2(3) of the Act,* which governs the terms "sale" or "sell" as used in Sections 5(a) and 12(1). We therefore address ourselves to the question whether an exchange in a consolidation is a "sale" within the meaning of the Act.

When this case was presented to the Circuit Court of Appeals, it was not denied by either defendant or the Securities and Exchange Commission (in its *amicus curiae* brief) that a voluntary exchange of stocks is ordinarily included within the term "sale" as used in the Act. Indeed, a contrary view was precluded by authorities such as

> *Securities and Exchange Commission v. Associated Gas & Electric Company* (D.C., S.D., N.Y., 1938) 24 Fed. Supp. 899 (Affirmed, C.C.A. 2, 1938, 99 Fed.(2d) 795);
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> *Indemnity Insurance Co. v. Kircher* (1934) 47 Ohio App. 140, 191 N.E. 374; and
>
> *Edward v. Ioor* (1919) 205 Mich. 617, 172 N.W. 620.

Nevertheless, it was contended that there is a difference between an exchange to which the individual stockholder's consent is necessary and one that is brought about by action of the directors and the necessary majority of stockholders acting in their corporate capacities. Defendant and the Commission must concede, however, that the distinction so sought to be drawn is not founded upon any express statutory provision and that the exemptions con-

*Quoted in Appendix to this Brief, page viii.

tained in the Securities Act show that Congress assumed that all exchanges are sales within that Act. For example, the pertinent portions of Section 3(a), subsections (9) and (10), exempt the following:

> "(9) Any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange;
>
> "(10) Any security which is issued in exchange for one or more bona fide outstanding securities * * * where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness * * * by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval."

These exemptions would have been unnecessary if an exchange of securities under a corporate plan did not constitute a sale. Recapitalization plans by amendment of articles, exempted by subdivision (9), are quite customarily adopted by action of directors and stockholders in corporate capacities, and reorganizations supervised by courts, exempted by subdivision (10), usually involve conversion of securities without the consent of the holder—particularly federal bankruptcy reorganizations. Why then did Congress consider it necessary to exempt them specifically?

The answer is that Congress did not intend to exempt exchanges like the one involved in this case. See the 1933 House Committee Report, which said with reference to an early draft of these exemption provisions:

> "Reorganizations carried out without such judicial supervision possess all the dangers implicit in the issuance of new securities and are, therefore, not exempt from the act. For the same reason the provision is not broad enough to include mergers or consolidations of corporations entered into without judicial supervision." [H. R. Rep. No. 85, p. 16, 73rd Congress, 1st Session, 1933.]

We urge that the principle so expressed by the House Committee is correct. The facts in this case demonstrate that the evils against which the Securities Act was aimed are quite as likely to occur in a consolidation or merger as in any other promotion.

Furthermore, since each preferred stockholder of the Delaware corporation in this case was entitled (by the plan and the Delaware law combined) to have a choice between three things, namely, 5½% convertible stock, or 6% non-convertible stock (R. 249, 261) or a money payment under the appraisal right,† it would seem clear that here the elements of voluntary offer and acceptance were present with respect to each stockholder individually. The registration provisions of the Act, therefore, applied in order to require full disclosure of this choice to the shareholders to whom the offer was made.

* * * * *

In connection with this Securities Act question, we should add that in the Circuit Court of Appeals defendant contended that if the exchange of stocks was a sale within the meaning of the Act, nevertheless the Securities and

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†If the stockholder knew the Delaware General Corporation Law, Section 61 (quoted in Appendix to this Brief, pp. vi-viii).

Exchange Commission had adopted a rule or regulation† to the effect that it was not an exchange; and that accordingly Section 19(a) of the Act‡ exempted the defendant from liability because of reliance on this regulation "notwithstanding that such rule or regulation may * * * be determined by judicial or other authority to be invalid for any reason." There are strong arguments opposed to this contention, including constitutional reasons, but we do not consider it appropriate to raise them in connection with the certiorari petition, because it does not seem to us that the possibility that Section 19(a) might exempt the defendant from liability in this particular case constitutes any answer to the suggestion that the Supreme Court should pass upon the highly important question whether an exchange in a consolidation (or other important corporate plan) adopted by vote of directors and stockholders comes within the registration requirements of the Act. Surely Section 19(a) could not contemplate that a federal court is forbidden to invalidate a regulation of the Securities and Exchange Commission merely because in the particular case before it the defendant might be exempted by Section 19(a) from actual liability on account of reliance upon such erroneous regulation prior to its invalidation. If that were the construction of Section 19(a), it would probably prevent any court from ever holding invalid any regulation of the Commission, since the defendant would always be protected by reliance on the wrongful regulation. Obviously the statute contem-

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†The Commission's Note to Rule 5(2) of the instructions as to Form E-1.

‡Quoted in the Appendix to this Brief, p. ix.

plates that when such a regulation is attacked as erroneous, the courts in the first case in which it is attacked must decide whether or not it is invalid, before going on to decide whether Section 19(a) can afford an exemption.

Here the highly important Federal question, on which the Supreme Court has not passed and on which the Circuit Court of Appeals has rendered such an unsatisfactory opinion (referring for its reasons solely to an unreported *amicus curiae* brief), is the question whether an exchange of securities in a consolidation, merger or other important corporate plan is a sale under the Securities Act. We urge that this question should be decided by the Supreme Court, and if the Court holds that such an exchange is a sale under the Act, then any erroneous regulation of the Commission will be overthrown as to the future, regardless of whether or not it may survive long enough to be a defense in any particular case which has arisen prior to such holding.

4. **THE CIRCUIT COURT OF APPEALS SO COMPLETELY IGNORES IMPORTANT FINDINGS OF THE DISTRICT COURT AS TO SET ASIDE SUCH FINDINGS WITHOUT CAUSE AND CONTRARY TO RULE 52(a) OF THE FEDERAL RULES OF CIVIL PROCEDURE.**

Nowhere does the Reversing Opinion question any finding for lack of supporting evidence or as contrary to the evidence or for any other cause. Instead, it disposes of the findings opposed to its theories by ignoring them. This is error under the provision of Rule 52(a) of the Federal Rules of Civil Procedure that:

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witness."

(a) Findings of Deliberate Intent to Defraud.

As we have demonstrated by quotations above, all the findings of deliberate intent to defraud for the financial benefit of the directors are overlooked in the Reversing Opinion. This may explain how the Court fell into the error of sustaining negligence as a defense to a wilful fraud. (See pages 9-15, above, where such findings are summarized and quoted).

(b) The Finding Which Negatives Negligence.

The very holding of negligence, namely, that plaintiff's representatives were negligent in relying on the letter, instead of reading the plan and agreement, ignores the finding of the District Court, quoted above on pages 18-19, that the letter appeared to be a summary of the plan and agreement and was intended by the directors so to appear. Although this finding is impregnably fortified by an admission of the same fact in the pleadings (R. 35, R. 162), the only notice the Circuit Court of Appeals takes of such *admitted fact* is to refer to it as merely an argument, saying near the beginning of the Reversing Opinion:

> "* * * it being *contended* that this letter was a purported summary upon which stockholders were entitled to rely without further inquiry." (R. 2991; emphasis supplied).

From then on the Reversing Opinion never refers again to the character of the letter as a summary of the legal

agreement, but treats it as just another document on the same level as the legal agreement, thus holding that plaintiff's representatives were not entitled to rely upon the letter alone. In this way the holding of negligence is based upon disregard of the one basic fact—an admitted fact—which negatives negligence.

(c) Numerous Findings Which Completely Answer Claims of Estoppel or Laches.

In our Statement of the Matter in the Petition we have shown the complete disregard of findings and evidence which led the Circuit Court of Appeals to mention estoppel and laches as makeweight defenses.* We adopt that showing by reference here. However, we want to explain in greater detail two of the examples there listed.

The first is the completely unsupported assertion in the Reversing Opinion that plaintiff Stanford accepted dividends on the new stock (R. 2989). If this had been true, it might have helped to justify the defense of laches. It is noteworthy that the headnote to the report of the Reversing Opinion in 134 Fed.(2d) at page 689 seizes upon this alleged circumstance as the chief ground for laches and estoppel, saying (headnote 3):

> "Where holder of preferred shares in Delaware corporation was fully advised of proposed consolidation as provided by statute and promptly advised that consolidation had become effective, *but stockholder accepted two quarterly dividends from new corporation* and made no objection until more than six months after effective date of consolidation, ac-

*Petition, pages 6-7.

tion for cash value of shares was barred by 'laches' and 'estoppel'." (Emphasis supplied)

However, the asserted acceptance of the dividends by Stanford was not true. On the basis of uncontradicted testimony the District Court found as follows:

> "The first two dividend checks which were mailed by defendant to plaintiff Shine after the effectuation of said consolidation plan were received and cashed by plaintiff Shine as nominee of the depositary Wells Fargo Bank & Union Trust Co. without knowledge that said dividends related to the stock of the defendant into which the stock of plaintiffs had by said consolidation plan been converted, and plaintiff Stanford University and the Board of Trustees thereof first discovered that said dividends pertained to stock of the defendant in April, 1938, and immediately upon making such discovery tendered the amount thereof, with full interest thereon at the legal rate, to defendant. Plaintiffs have refused to accept all subsequent dividends thereon." (R. 282)

The other important example of the complete disregard of findings in the Reversing Opinion is the failure to note that the delay of plaintiff in bringing suit—a "mere" delay for seven months at the most*—did not prejudice defendant or its predecessors and therefore could not have constituted either laches or estoppel. The District Court made the following finding, which is never mentioned by the Circuit Court of Appeals:

> "If plaintiffs had learned the true facts with reference to said consolidation at the earliest possible time and had filed said action and done each and all of said

*See Petition, page 6, footnote *.

> acts and things done by them at the earliest possible time neither said board of directors nor said constituent companies nor any one or more of them would have done any act or thing with reference to said consolidation other or different from what they did, except only that the defendant might long since have paid plaintiffs the value of the said 1300 shares of 7% preferred stock belonging to the plaintiffs for recovery of which value this suit was brought." (R. 283)

This finding that the adoption and carrying out of the plan would not have been changed or affected in any way, if plaintiff had acted at the earliest possible time, is based upon the express testimony to that effect of the President of both the Delaware corporation and defendant (R. 1084-93), so that it must be unimpeachable as against defendant. Such finding completely eliminates both laches and estoppel, because it proves there was no injury to defendant from any delay of plaintiff, and neither of these defenses can arise from mere delay for less than the statutory period of limitations, unless the defendant has been *prejudiced* by plaintiff's failure to act.

> *London & San Francisco Bank v. Dexter Horton & Co.* (C.C.A., 9, 1903) 126 Fed. 593, 601-2 (Cert. den. 194 U.S. 631);
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> *Northern Pac. Ry. v. Boyd* (1913) 228 U.S. 482, 508-10 (affirming 177 Fed. 804, C.C.A., 9, 1910; see 177 Fed. 822-4);
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> *Russell v. Todd* (1940) 309 U.S. 280, 287;
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> *Victor Oil Co. v. Drum* (1920) 184 Cal. 226, 242-3; 193 Pac. 243, 250;
>
> *Fry v. Board of Education* (1941) 17 Cal.(2d) 753, 761; 112 Pac.(2d) 229, 234-5.

In addition, it seems to us that the Circuit Court of Appeals was misled into accepting as a bona fide defense something which was laid as a trap for plaintiff and other stockholders. The Record shows that the Delaware corporation's attorney and director, who drew all the consolidation papers, wrote to the Secretary-Treasurer on March 28, 1938, with reference to a proposed "follow-up" letter to stockholders about exchanging their old stock certificates for the new securities as follows:

> "It would be my judgment to wait from three to six months longer. Such a letter might stir up the stockholders to present claims, and the longer they *delay* presenting claims the more apt the court will be to throw them out on the ground of laches without going into the question of merits." (R. 1537)

Regardless of this, however, we submit that the ignoring of so many important trial court findings by the Circuit Court of Appeals calls for exercise of the Supreme Court's power of supervision—calls for an instruction from the Supreme Court directing the Circuit Court of Appeals to cease the disregard of District Court findings.*

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*See *Stewart v. United States* (1942) 316 U.S. 354, in which the Supreme Court, after granting certiorari, reversed *United States v. Stewart* (C.C.A. 9, 1941) 121 Fed.(2d) 705, for the same kind of failure to give weight to a trial court finding.

5. THE CIRCUIT COURT OF APPEALS ERRED IN HAVING PLAINTIFF'S PETITION FOR A REHEARING BY THE ENTIRE COURT IN BANK PASSED UPON SOLELY BY THE THREE JUDGES WHO DECIDED THE CASE IN THE FIRST INSTANCE, CONSTITUTING LESS THAN A MAJORITY OF THE APPELLATE COURT.

It seems to us that the Circuit Court of Appeals must have erred and must be continually erring in its practice of treating a petition for a rehearing in bank as if it were only an ordinary petition for rehearing, to be passed upon by the same Judges who decided the case in the first instance. This practice seems particularly questionable in a case like this, where there is a conflict with a prior opinion of a different group of Judges of the same Court; and it would seem a doubtful practice in any case involving so many conflicts with established principles and with opinions of the United States Supreme Court, other Circuit Courts of Appeals and state appellate courts.

However, this question of practice does not affect the merits of our case and therefore we do not propose to present arguments as to the error in any more detail than that in which they have already been indicated in the Petition (pages 13-15). We believe that there is involved a problem of appellate procedure which is of importance to the Federal bench and bar and, in our view, should be passed upon by the Supreme Court. But it is only an incidental question in our client's cause and we prefer to confine our argumentation to the merits of that cause. We refer again to the serious injustices accomplished by

the decision of the Circuit Court of Appeals on the merits, as explained above in the Petition and this Brief.

Petitioners urge that a writ of certiorari be granted.

Respectfully submitted,

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Dated: San Francisco, California, August 2, 1943.

(APPENDIX FOLLOWS.)